

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 FEA-01 AEC-07 AID-05 CEA-01 CIAE-00

CIEP-02 COME-00 DODE-00 EB-07 FPC-01 H-02 INR-07

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TO SECSTATE WASHDC 5749

INFO AMEMBASSY DUBLIN

AMEMBASSY OSLO

USMISSION EC BRUSSELS

USMISSION OECD PARIS

UNCLAS SECTION 01 OF 03 LONDON 15013

DEPT PLEASE PASS TREASURY

E.O. 11652: N/A

TAGS: ENRG, UK

SUBJECT: HMG OFFSHORE OIL AND GAS POLICY: NEW
PETROLEUM REVENUE TAX AND PARTICIPATION NEGOTIATIONS
ANNOUNCED

REF: LONDON 9104, 8800, 8680

SUMMARY: AS FORESHADOWED BY JULY 11 WHITE PAPER AND
CHANCELLOR HEALEY'S BUDGET MESSAGE ON PRECEDING DAY,
PAYMASTER GENERAL EDMUND DELL ANNOUNCED TO PARLIAMENT ON
NOVEMBER 13 THAT HMG WILL TABLE LEGISLATION NEXT WEEK--
IN FORM OF AN OIL TAXATION BILL--TO IMPOSE A NEW
PETROLEUM REVENUE TAX (PRT) ON PROFITS OF OIL COMPANIES
OPERATING ON UK CONTINENTAL SHELF. HE ALSO ANNOUNCED
SECRETARY OF STATE FOR ENERGY VARLEY HAD WRITTEN ON
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NOVEMBER 12 TO OIL COMPANIES ENGAGED IN NORTH SEA

EXPLOITATION INVITING THEM TO BEGIN NEGOTIATIONS ON QUESTION OF GOVERNMENT PARTICIPATION IN EXISTING LICENSES. NEGOTIATIONS ARE TO BE UNDERTAKEN BY HAROLD LEVER (CHANCELLOR OF THE DUCHY OF LANCASTER) ASSISTED BY LORD BALOGH (MINISTER OF STATE FOR ENERGY) AND DELL. MAIN POINTS OF DELL'S PRESENTATION WERE THAT (A) PRT WOULD BE ON AN INDIVIDUAL FIELD RATHER THAN ON CONSOLIDATED BASIS; THAT PRT WOULD BE A PRIOR CHARGE ON PROFITS BEFORE ORDINARY CORPORATION TAX; AND THAT, ALTHOUGH NO ALLOWANCE WOULD BE MADE FOR INTEREST CHARGES, THERE WOULD BE AN "UPLIFT" (INCREASED AMORTIZATION BASE) OF 50 PERCENT FOR CERTAIN CAPITAL EXPENDITURE. HE ALSO STATED THAT WHILE PRT WOULD APPLY TO BOTH OIL AND GAS OUTPUT AS OF NOVEMBER 12, THERE WOULD BE SPECIAL PROVISIONS FOR FIELDS ALREADY IN PRODUCTION IN SOUTHERN BASIN OF NORTH SEA. END SUMMARY

1. RULES OF NEW PETROLEUM REVENUE TAX (PRT) WILL APPLY AS OF NOVEMBER 13 TO BOTH OIL AND GAS AND WILL BE SET OUT IN OIL TAXATION BILL WITH ACTUAL TAX RATE TO BE DETERMINED BY PARLIAMENT IN 1975 FINANCE BILL. PRT WILL APPLY TO PRODUCTION, NOT TO REFINING OR OTHER PROCESSING OF PETROLEUM. FOR PURPOSE OF TAX, ALLOWABLE EXPENDITURE IN A FIELD WOULD BE AVAILABLE TO BE SET AGAINST RECEIPTS FROM THE FIELD WHEN IT IS INCURRED, SUBJECT TO PROCEDURES FOR CLAIMING RELIEF FOR ABORTIVE EXPENDITURE. CERTAIN CAPITAL EXPENDITURE, INCLUDING THAT ON PRODUCTION AND TRANSPORTATION, WOULD QUALIFY FOR AN UPLIFT OF 50 PERCENT BUT NO ALLOWANCE WOULD BE MADE FOR INTEREST. THIS ALLOWANCE OF 150 PERCENT OF CAPITAL EXPENDITURE WILL BE A SUBSTANTIAL BENEFIT TO COMPANY CASH FLOWS.

2. PRT WOULD BE A TAXATION PRIOR CHARGE ON PROFITS--IN OTHER WORDS, IT WOULD STAND IN FRONT OF CORPORATION TAX AND WOULD BE DEDUCTIBLE IN COMPUTING PROFITS FOR CORPORATION TAX PURPOSES. PRT WOULD APPLY TO OIL AND GAS, BUT THERE WOULD BE SPECIAL PROVISIONS FOR FIELDS ALREADY IN

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PRODUCTION INCLUDING SOUTHERN BASIN GAS FIELDS. ALLOW-
ANCE WOULD BE MADE FOR PAST COSTS, BUT NO ACCOUNT WOULD
BE TAKEN OF PRE-BUDGET DAY RECEIPTS FROM OIL OR GAS.

3. HMG WOULD CERTAINLY LISTEN TO AND CONSIDER ANYTHING
OIL COMPANIES HAD TO SAY IN WAY OF OBJECTIONS TO ASPECTS
OR DETAILS OF STRUCTURE OF TAX, BUT IT IS CLEAR THAT THE
PRIOR CHARGE ASPECT AND FIELD-BY-FIELD BASIS ARE FUNDA-
MENTAL ELEMENTS IN THE CONCEPTION OF PRT.

4. OIL TAXATION BILL WOULD NOT STATE RATE OF TAX.
PARLIAMENT WOULD BE ASKED TO APPROVE RATE IN FINANCE
BILL NEXT SPRING BUT THAT DOES NOT MEAN ANNOUNCEMENT OF
RATE WOULD NECESSARILY HAVE TO WAIT UNTIL THEN. ON THE
CONTRARY, FROM POINT OF VIEW OF OIL COMPANIES, SOONER
UNCERTAINTIES ABOUT NEW TAX COULD BE RESOLVED, THE
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BETTER.

5. PRT WILL NOT EXIST IN ISOLATION. GOVERNMENT "TAKE"
WOULD NOW HAVE 4 COMPONENTS: EXISTING ROYALTIES; COR-
PORATION TAX, COMPUTED IN NORMAL WAY, BUT MODIFIED BY
CHANGES INDICATED BELOW; NEW PETROLEUM REVENUE TAX; AND,
WHERE APPLICABLE, PROCEEDS OF DIRECT STATE PARTICIPATION
IN OIL LICENSES, TO BE FREELY NEGOTIATED WITH OIL
COMPANIES IN NEXT FEW MONTHS.

6. OIL COMPANIES WERE CONCERNED TO KNOW AS SOON AS POSSIBLE THEIR NET POSITION AFTER ALL THESE DIFFERENT FACTORS HAD BEEN TAKEN INTO ACCOUNT. GOVERNMENT HAD ALREADY MADE ITS OWN CALCULATIONS AND, THEREFORE, HAD ITS OWN IDEAS ABOUT APPROPRIATE RATE, BUT THERE WERE STILL UNCERTAINTIES IN POSTURE WHICH AROSE NOT FROM NATURE OF TAX SYSTEM OR OF OTHER RELATED CHANGES, BUT FROM PHYSICAL FACTS OF EXPLORATION IN NORTH SEA AND FROM NATURE OF OIL BUSINESS. REGARDING INCREASING COSTS OF NORTH SEA DEVELOPMENT, SOME OF THIS SIMPLY REFLECTED INCREASE IN LEVEL OF PRICES GENERALLY. SOME MIGHT REPRESENT AN INCREASE IN REAL OR CONSTANT PRICE TERMS DUE TO PREVIOUS OVER-OPTIMISM ABOUT SHEER TECHNICAL DIFFICULTY OF EXTRACTING OIL IN SUCH INHOSPITABLE WATERS.

7. HMG NEEDED TO TAKE INTO ACCOUNT LIKELY RANGE OF VARIOUS ESTIMATES IN FIXING OFFICIAL RATE FOR TAX. BEFORE RATE WAS FINALLY SETTLED, PAYMASTER GENERAL INTENDS TO HAVE FURTHER EARLY AND DETAILED DISCUSSIONS WITH OIL COMPANIES ABOUT THEIR PRESENT AND FUTURE LEVELS OF COST AND ABOUT EFFECT OF TAX PROPOSALS ON FUTURE PROFITABILITY ON NORTH SEA OPERATIONS. IN DECIDING RATE, HMG WOULD HAVE FULLY IN MIND THAT WHILE DETERMINED TO ACHIEVE ITS OBJECTIVES, GOVERNMENT FULLY RECOGNIZED THAT TAX MUST LEAVE OIL COMPANIES WITH ADEQUATE RETURN ON THEIR CAPITAL AND SUFFICIENT INCENTIVE TO CONTINUE WITH DIFFICULT AND HAZARDOUS WORK IN NORTH SEA WHICH THEY HAD BEEN UNDERTAKING WITH DETERMINATION AND SKILL. IN PARTICULAR, GOVERNMENT WAS CONSCIOUS OF NEED NOT TO DETER INVESTMENT IN THE MARGINAL FIELD. IT WOULD CERTAINLY ARRANGE THINGS SO THAT COMBINED EFFECT OF FISCAL AND OTHER MEASURES

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CONTEMPLATED MADE ALLOWANCES FOR THIS PROBLEM.

8. CONSULTATIONS ABOUT PRT AND NEGOTIATIONS ABOUT PARTICIPATION WERE TWO SEPARATE, BUT RELATED, PROCESSES INVOLVING TWO SEPARATE SETS OF DISCUSSION. HOWEVER, THREE MINISTERS CONCERNED (LEVER, BALOGH AND DELL) WOULD BE

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WORKING VERY CLOSELY TOGETHER. IMPORTANT POINT WAS THAT
PRT STOOD AS A TAX IN ITS OWN RIGHT AND ITS ENACTMENT WAS
NOT DEPENDENT ON PROGRESS WITH PARTICIPATION NEGOTIATIONS.

9. AS FOR CORPORATION TAX AMENDMENTS CONCERNED WITH
PROFITS FROM NORTH SEA, IT HAD ALREADY BEEN ANNOUNCED (IN
JULY WHITE PAPER) THAT THERE WOULD BE A RING FENCE FOR
CORPORATION TAX PURPOSES AROUND PROFITS FROM UK, TERRI-
TORIAL WATERS AND CONTINENTAL SHELF, SO THAT THEY WOULD
NOT BE REDUCED BY ALLOWANCES AND LOSSES FROM EXTRANEIOUS
ACTIVITIES. THESE MEASURES WOULD APPLY TO GROUP RELIEF
AND TO SIMILAR SET-OFFS WITHIN A SINGLE COMPANY AND A
COMPANY WITH LOSSES OR EXCESS ALLOWANCES WOULD NOT BE
ABLE TO USE THEM TO CLAIM PAYMENT OF IMPUTATION TAX
CREDIT ON DIVIDENDS RECEIVED FROM A COMPANY WITHIN ITS
GROUP AND PAID OUT OF NORTH SEA PROFITS. RING FENCE
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WOULD APPLY TO ACCOUNTING PERIODS ENDING AFTER JULY 11,
1974.

10. IT WOULD BE GENERALLY AGREED CORPORATION TAX YIELD FROM NORTH SEA, WHICH WOULD BE SUBSTANTIAL, SHOULD NOT BE AT RISK OF COMPANIES BRINGING ALL SORTS OF ACTIVITIES AND EXPENDITURE INTO UK TAX NET MERELY SO AS TO GET RELIEF AGAINST NORTH SEA PROFITS. HOWEVER, RING FENCE WOULD FACE ONLY ONE WAY: LOSSES AND ALLOWANCES ON CONTINENTAL SHELF WOULD STILL BE ABLE TO BE SET AGAINST PROFITS FROM ACTIVITIES ELSEWHERE.

NOTE: A SECOND CORPORATION TAX AMENDMENT CONCERNED WITH PROFITS FROM TRADE OUTSIDE NORTH SEA ALSO WAS DEALT WITH AT LENGTH. ITS EFFECTS, HOWEVER, WOULD BE ON OIL COMPANIES WHICH HAVE BENEFITED FROM ARTIFICIAL TRANSFER PRICES ON MIDDLE EAST OIL SOLD AT POSTED PRICES BY PRODUCTION COMPANY TO MARKETING COMPANY BOTH OF WHICH ARE RESIDENT IN UK AND SUBJECT TO TAX ON THEIR PROFITS. AS REPORTED PREVIOUSLY, NO US COMPANIES WOULD BE AFFECTED BY THIS PARTICULAR AMENDMENT.

11. COMMENTS FOLLOW BY SEPTTEL.

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